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SENSITIVE
SIPDIS

DEPT PASS USAID AFR/SD FOR CURTIS, ATWOOD AND SCHLAGENHAUF
DEPT PASS TO USTDA-PAUL MARIN, EXIM-JRICHTER
DEPT PASS TO USTR-LAURIE-ANN AGAMA
DEPT PASS TO OPIC-BARBARA GIBIAN AND STEVE SMITH
JOHANNESBURG FOR JASON NAGY
USDOE FOR GEORGE PERSON
TREASURY FOR IERONIMO, BARCAN, SOLOMON AND RITTERHOFF
DOC FOR 3317/ITA/OA/BURRESS AND 3130/USFC/OIO/ANESA/REED

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SUBJECT: ENERGY SCENESETTER FOR THE VISIT OF COORDINATOR FOR
INTERNATIONAL ENERGY AFFAIRS DAVID GOLDWYN, NOVEMBER 9-11, 2009

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OVERVIEW

1. (SBU) The oil and gas industry in Nigeria accounts for 92 percent of export earnings and 85 percent of GON revenues, according to the World Bank. Nigeria is the 12th largest producer of crude in the world, the 8th largest exporter, and is the world's 10th largest crude oil reserves at 36.2 billion barrels. Its production currently averages 1.8 million barrels per day, but this could increase after the GON's amnesty program in the Delta and as "shut-in" fields are brought back into production. The GON wants to produce three million barrels per day by 2015. Nigeria has 184 trillion cubic feet of proven natural gas reserves, and is the second largest flarer of natural gas in the world and the largest in Africa.

UPSTREAM PETROLEUM INDUSTRY

2. (SBU) Nigeria's oil is produced from five sedimentary basins: the Niger Delta, Anambra, Benue Trough, Chad, and Benin. The Niger Delta, both the onshore and shallow offshore basins, are reported to be well-explored. Ventures here are low-risk, and the basins contain about 80 percent of the country's producing wells. The emergence of offshore oil and gas operations and the granting of deep water acreages to the international oil companies (IOCs) are producing a shift from Joint Operating Agreements (JOA) to Production Sharing Contracts (PSCs) due to the complexity of offshore operations.

3. (SBU) The Nigerian National Petroleum Corporation (NNPC) represents GON interests in the joint ventures (JV) with the IOCs. The JOA governs the partnership, including budget approval and supervision, crude oil lifting and sale in proportion to equity, and funding. A Memorandum of Understanding (MOU) governs the way proceeds are allocated between the partners, including payment of taxes, royalties, and industry margin. Operational income is shared in proportion to the parties' equity interests in the venture, with each party bearing the cost of its royalty and tax obligations in

the same proportion. Allocations are also made from the revenue to cover operating and technical costs. There are six JVs with Shell, Chevron, Mobil, Agip, Elf, and Texaco/Chevron.

14. (SBU) The PSC governs the relationship between the parties in the offshore blocks. The contractor, usually an IOC, bears the entire cost and risk of the exploration activities, and only reaps the rewards after a commercial discovery. In the event of a commercial discovery, the contractor recovers its costs fully from the allocation of oil, referred to as "cost oil." Allowance is also made from production for royalties, after which the remainder of the production, called "profit oil," is shared in previously-agreed-upon proportions between the company and the GON. The contractor company thereafter pays income tax on its profits from the venture. The oil and all the installations remain the property of the GON throughout the contract. There are ten PSC operators: Statoil, Snepco, Elf, Agip, Addax (now Sinopec), Conoco, Petrobas, Star Deep Water (Texaco), Chevron, and Oronto Phillips, according to the NNPC's website. (NOTE: China National Offshore Oil Corporation (CNOOC) acquired a 45 percent working interest in offshore oil mining license oil mining license 130. The purchase was reported in the local press at \$2.3 billion from South Atlantic Petroleum Limited (SAPETRO) and was described as a PSC operation. END NOTE).

15. (SBU) Efforts to reduce flaring have not been successful due to security issues, insufficient funding, low domestic gas prices, and slow development of a commercially-viable gas market. The GON's policy is to attain zero gas flaring by 2011, but the GON is not expected to achieve this goal. The GON is encouraging anti-flaring investment through the use of the incentives within the Clean Development Mechanism (CDM).

DOWNSTREAM PETROLEUM INDUSTRY

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16. (SBU) Nigeria's downstream petroleum industry operations are state-owned and include gas distribution/sale, petroleum product distribution and storage, and petroleum product retail. There are three petrochemical plants in Warri and Kaduna. The downstream operation has 5,000 kilometers of pipeline network, 21 storage depots, and nine liquid petroleum gas (LPG) depots. Efforts have been made to increase the nation's refining capacity, petroleum product distribution, natural and petroleum gas utilization, and petrochemical development projects. Nigeria's four state-owned refineries have an installed capacity of 445,000 barrels per day. They have a history of fire, sabotage, poor management, lack of turn-around maintenance, and corruption. These elements have limited refinery output to 40 percent of capacity or less. Minister of Petroleum Resources Dr. Rilwanu Lukman has swayed in the past year between upgrading the refineries and selling them outright, which has resulted in shortages of refined product and the need to increase imports to meet domestic demand. As a result, Nigeria is the only OPEC member that imports the majority of its refined product needs.

17. (SBU) Corruption is found in the distribution and marketing chain with frequent allegations of cross-border smuggling. NNPC is the oil and gas sector regulator and sets wholesale and retail prices. The GON is in the process of full deregulation of the downstream sector as outlined in the Petroleum Industry Bill (PIB). Diesel and jet fuel were fully deregulated in early 2009. Labor unions, importers, and some civil society groups oppose the deregulation of gasoline and domestic kerosene, which is planned for early 2010. The GON finds the fuel subsidy of \$4.3 billion in 2009 to be unsustainable, and is alleged to benefit less than five percent of the population, i.e., those who are affluent enough to afford vehicles. Nigeria exports 22 million tons of liquefied natural gas (LNG) and 2.2 million metric tons of LPG. In 2010, it is scheduled to complete the 420-mile West African Gas Pipeline, which will carry natural gas from Nigeria to Ghana via Togo and Benin. Discussion to construct a \$12 billion, 2,500-mile Trans-Saharan Gas Pipeline to Algeria's Beni Saf export terminal on

the Mediterranean is a "hot" topic in Nigeria. Total and Gazprom have expressed interest in the pipeline.

PROPOSED LEGISLATION

18. (SBU) The Nigerian Content Development Bill was passed in the Senate on April 17, 2008, and by the House of Representatives on October 22, 2009. The Senate and House versions are being reconciled and completion is expected by November 15, 2009. The Bill is designed to enhance local participation in Nigeria's oil and gas sector, and has important implications for operators, contractors, subcontractors, and financial and legal service providers. It is a companion piece to the Petroleum Industry Bill (PIB). Stakeholders in the oil and gas industry doubt the nation's ability to attain the required percentage of local content by 2010. The international oil and service companies have been preparing for the 2010 deadline but admit that it will take its toll on costs, productivity, and efficiency. There are 13 significant items for reconciliation, the most important being the requirement for operators to maintain bank accounts in Nigeria with at least ten percent of their total revenue and to contribute up to one percent of their project costs to the Nigerian Content Development Fund.

19. (SBU) The PIB is an omnibus legislation that will replace the existing 16 oil sector laws with one legal framework with clear rules, procedures, and institutions. The stated objective of the new law is to bring about transparency, good governance, and reduce corruption. The Mission has supported the oil and gas reform and has worked with both the GON and the IOCs on issues of concern within the PIB. The PIB has had two readings in the National Assembly and public hearings were held July 27-31. The Senate and House joint PIB committees have completed a draft report and will take a retreat in mid-November to come to final agreement. Today, the gap between the GON and the IOCs on a variety of issues has

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narrowed. These issues include greater support for the southern oil communities, positive movement on taxation, and deregulation of downstream production. Major differences still exist over the total rate of taxation, the sanctity of contracts, and international arbitration.

10. (SBU) The Nigerian Content Development Bill, the PIB, and the Nigeria Gas Master Plan (NGMP) are all part of the National Oil and Gas Policy that would reform the oil and gas industry and introduces a formal mid-stream sector. The planning and implementation of the policy is the responsibility of the President's Oil and Gas Sector Reform Implementation Committee (OGIC). The NGMP is expected to cost approximately \$30 billion for infrastructure development which includes: a gas pricing policy; a gas supply obligation regulation; and a gas infrastructure blueprint. The NGMP calls for three sectors of pricing: domestic sector cost (grid power); industrial sector - netback; and commercial sector - alternative fuels pricing. The GON recently implemented the Domestic Gas Supply Obligation Regulation that mandates the JVs to provide gas for industries such as methanol, fertilizer, and power. (NOTE: The NGMP calls for gradual migration of the gas-to-power price from \$0.1 per thousand cubic feet to \$1.0 per thousand cubic feet by January 2012. An additional \$0.3 per thousand cubic feet is provided for gas transmission to power plants. The IOCs lament that the 2008 price of \$0.1 per thousand cubic feet is too low. END NOTE) At the core of the proposed infrastructure blueprint are three gas-gathering and processing systems, each of which will gather gas across a delineated area, process the gas into a national specification, and export the dry gas into the network of gas transmission systems. Nigeria needs private sector participation for the delivery of these infrastructure elements. (NOTE: GAZPROM has shown interest in participating in the midstream gas gathering sector. END NOTE).

EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE (EITI)

¶11. (SBU) Nigeria was among the first countries to "domesticate" EITI by passing a Nigeria EITI law in 2007. The USG provided legislative strengthening and advocacy support to the National Assembly and civil society that facilitated the passage of the NEITI law. The NEITI legislation codifies the EITI principles and processes, providing a statutory basis for promoting transparency, accountability, and due diligence in the management of revenues from extractive industries in Nigeria. The law also allows for significant civil society oversight. Technical assistance to civil society organizations (CSO) and relevant National Assembly committees are ongoing to improve their understanding of extractive industry revenue transparency issues to adequately carry out their oversight responsibilities in the implementation of the law. The Oversight responsibilities in the implementation of the law. The 2005 EITI audit has been completed and accepted by the President's Executive Council. The 2006, 2007, and 2008 audits will be completed when the contract is awarded.

¶12. (U) Nigeria also agreed to publish and disseminate the EITI report and to have an independent validator verify fulfilment of agreed-upon EITI indicators. USAID has received approximately \$1.5 million in Anti-Corruption Initiative (ACI) funds to address EITI issues, and is building the capacity of civil society to engage in the EITI process while the World Bank and DFID are providing support to the NEITI Secretariat. The USG is conducting an assessment to identify states in the Niger Delta that can work with donors and the GON as EITI lead states. Bayelsa State, for example, has adopted EITI at the state level.

POWER SECTOR

¶13. (SBU) Nigeria's power generation problems are: inadequate maintenance of aged generating plants; poor gas supply; vandalization of gas pipelines; and a shortfall in water systems for hydro plants. The country's transmission and distribution networks are characterized by single circuit radial lines (which exacerbate the grid's fragility and increase the likelihood that a disruption

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in any part of the system will result in major power outages to a large section of the country, rather than just the immediately affected area), overloaded transformers, obsolete substation equipment, and high incidences of line tapping for electricity theft. The capacity of the transmission grid is 4,000 megawatts with an average of 2,400 megawatts of generation, which is well below national needs. The grid reaches about 40 percent of the population and 10 percent of rural households.

¶14. (SBU) The Ministry of Power has developed and implemented the first phase of a strategic plan to provide an average of 6,000 megawatts of power by December 2009 through the rehabilitation of existing power plants, strengthening of the distribution and transmission grids, and expansion of the transmission system. The second phase of the plan is to deliver an average generation of 10,000 megawatts by December 2011 through an expansion of the transmission grid to 16,000 megawatts, the completion of eight National Integrated Power Project (NIPP) plants, and independent power plants (IPP) from the JVs. Power beyond this level, planned at 20,000 megawatts, will come from future IPPs and the completion of the Mambilla and Zungeru hydro-plants totalling 3,550 megawatts. The budget for the 6,000 megawatts and 10,000 megawatts was provided through the 2008 and 2009 Ministry of Power operating and capital allocations as well as a \$5.3 billion disbursement from the CBN Excess Crude Account. The lack of gas and gas infrastructure threaten the 6,000 megawatts goal. Some plants are almost ready; other units are on schedule, but sit idle without a gas supply. An additional 450 million standard cubic feet of gas is needed to power existing functional turbines. NNPC is looking at providing LPG or Synthetic Natural Gas (SNG) for feedstock, and Minister of Power Dr. Lanre Babalola is considering coal and solar power to diversify away from gas. There are also problems with adequate transmission capacity where two or more generating plants are trying to dispatch power through the same line, exceeding the line's capacity.

¶15. (SBU) The Nigerian Electricity Regulatory Commission (NERC) was established by the Electric Power Sector Reform Act of 2005 to:

- promote competition and facilitate a more rapid provision of service throughout the country;
- create a new legal and regulatory environment for the sector that establishes a level playing field;
- restructure and privatize the National Electric Power Authority (NEPA) - now Power Holding Company of Nigeria - PHCN); and
- encourage the successors to NEPA to undertake investment programs (11 distribution companies, six generation companies, and one nationalized transmission company).

¶16. (SBU) NERC has performed well. It has developed and implemented a multi-year tariff order (MYTO) that calculated for the first time the "real" cost of power and applied it to the power rates. The rates establish a wholesale rate for power and wheeling charges. The rates establish a wholesale rate for power and wheeling charges necessary to attract IPPs. The IPP industry has challenged the wholesale rate and asked to have it reviewed as the price of gas for power was taken from the Gas Master Plan. The Ministry of Power and NERC held a meeting of the electricity sector to disseminate the Nigerian Electricity Health and Safety Standards Manual and to declare that the industry is now accountable to the standards and that infractions will be punishable by law. This manual and an accompanying train-the-trainer program were funded by USTDA. U.S. United States Agency for International Development (USAID) provides support to NERC by funding selected travel and training costs for a mentoring/capacity-building program between NERC and the Michigan Public Service Commission (MIPSC). The program sponsor is the National Association of Regulatory Utility Commissioners (NARUC) Energy Regulatory Partnership Program.

SANDERS